Ontario Tax Expenditures

MINISTRY OF
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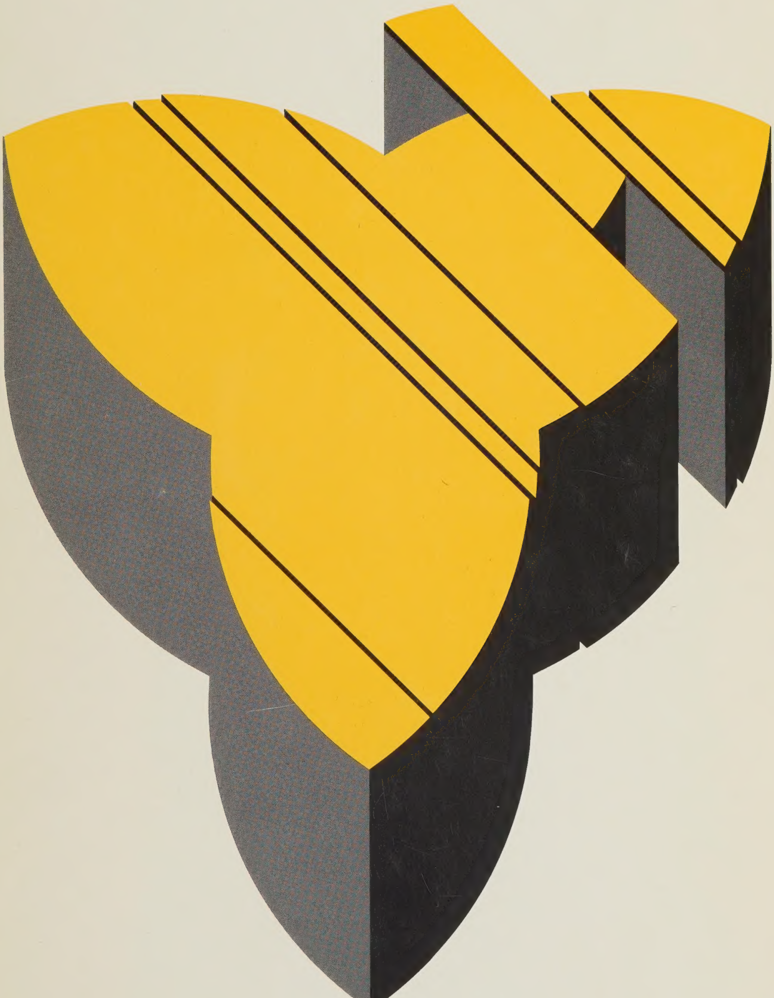

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Table of Contents

Introduction

This paper deals with a subject of growing interest and concern to governments and taxpayers alike: the controversial and frequently misunderstood subject of tax expenditures. Its purpose is to facilitate informed public discussion, the starting point for which must be a description of the major tax expenditures currently in place.

The entire concept of tax expenditures is extremely subjective. Some regard them as "hidden" benefits bestowed by governments. Others see them as a legitimate and more efficient way of delivering benefits and incentives. And still others would look upon at least some tax expenditures as more of a "right" than a benefit.

In the simplest terms, tax expenditures are taxes that governments deliberately do not collect to encourage certain types of activity (such as saving for one's retirement), or to help certain groups (such as people who must buy wheelchairs), or because such taxation would be considered unfair. As such, they are exceptions to the normal tax rules.

The main attraction of tax expenditures is that they cost much less to administer than other forms of benefits, especially when there is a large number of recipients. The main drawback is that they are not subject to the same degree of accountability as direct spending programs. When a government spends money directly, the legislature approves specific appropriations. But the cost of tax expenditures depends on how many people or corporations avail themselves of the potential benefits. This paper provides cost estimates of the most significant tax expenditure programs in which the Province is involved.

All taxes are determined by applying a *rate* (usually a specified percentage) to a *base* (such as taxable income or, in the case of the retail sales tax, the amount of the purchase). The value or cost of a tax expenditure is thus determined by estimating what revenues would have been collected if the normal rate were applied to a specific base.

But determining the "normal" tax rate or tax base is not always a straightforward matter. For example, there are three different corporate income tax rates applicable in Ontario. There is also a multitude of views about which items should, or should not, be considered as normal parts of the retail sales tax base. The estimates presented in this paper, therefore, are based on judgements about the appropriate standard, and where no reasonable benchmark can be identified, no estimates are made.

As already noted, the whole concept of tax expenditures involves a number of subjective judgements. In the area of *rate* and *base* it should be noted that the concept is usually applied to an untaxed base, rather than to the difference between two rates. To illustrate, most food purchased in grocery stores is not subject to retail sales tax, and this is usually regarded as a tax expenditure. In Ontario, beverage alcohol purchased at retail outlets for home consumption is taxed at 12 per cent, five per cent

higher than the general retail sales tax (RST) rate. Yet few would apply this five per cent to the general RST base to say that this too represents a tax expenditure. Like the elusive shapes glimpsed in cumulus clouds, many tax expenditures are there only for those who choose to see them.

A few additional cautions regarding the data presented in this paper:

- Economic conditions can have a dramatic impact on the cost and importance of tax expenditures. For example, the 1982 recession depressed the level of capital investment in machinery and equipment in Ontario. During the boom year of 1981, the level of machinery and equipment purchases grew by 22.5 per cent. But the following year, with the recession in full swing, the level declined by 4.3 per cent. These conditions were reflected in the costs of tax expenditures associated with capital investments. The cost of the tax expenditure associated with the excess of tax depreciation over book depreciation increased by 17 per cent in 1981, but declined by more than 30 per cent in 1982.

- Tax expenditures are often designed to encourage certain types of behaviour that governments regard as desirable -- anything from investing in feature films to saving for one's retirement. It is important to note that in the absence of such incentives people or corporations might behave differently, with the result that the cost of a tax expenditure may be overstated if based on what happens when an incentive is applied.

  For example, the tax deferrals available under Registered Retirement Savings Plans (RRSPs) encourage millions of Canadians to save for their retirement and, as a consequence, the federal and provincial governments forego a certain amount of revenue that they would otherwise receive. Without the incentive, many Canadians would save for their retirement in other ways. The method used to cost tax expenditures assumes that money contributed to RRSPs would be taxable. To the extent taxpayers would divert this income to other tax shelters, it overstates the cost of the tax expenditure.

- A tax expenditure may represent a deferral of taxes payable, rather than an absolute reduction. Calculating the amount of foregone revenue, therefore, means trying to estimate how much tax will eventually be paid -- a complex exercise. In the case of tax deferral schemes such as RRSPs, this paper estimates only the current revenue loss from tax deferrals without regard to future tax paid on the income when it actually becomes subject to tax. For example, most RRSP holders will pay some tax on the deferred income after they retire, although usually at a lower marginal rate. Therefore, this approach overstates the ultimate cost of Ontario's tax expenditures.

- Finally, the sources of data used to estimate the tax expenditures contained in this paper vary significantly. The majority of numbers in

the personal income tax area are derived from data for the 1983 tax year made available by the federal government to the Province under the terms of the Tax Collection Agreement. Corporate income tax expenditure estimates are based on Statistics Canada data and on unpublished Ontario Ministry of Revenue data. Statistics Canada is also the source of many of the estimates in the retail sales tax area. The basis for other tax expenditure estimates includes unpublished statistics supplied by a number of other Ontario ministries. Because cost estimates are based on the most recent available data in each case, some estimates do not relate to the same year, and in some instances they relate to the fiscal, rather than the calendar year.

Although this paper attempts to estimate the costs of individual tax expenditures, it would be misleading and inappropriate to add up all these estimates to arrive at a grand total. The tax system, as a feature of the economy in which it operates, is a dynamic entity. Changes in any part of the system affect other parts of the system. The overall cost of a group of tax expenditures could only be captured in a single number by taking into account the complicated interrelationships with the existing tax base and with other tax expenditures. For example, if the basic personal exemption -- the first tax expenditure listed in this paper -- had not existed in 1983, taxpayers would have had $2.46 billion less to spend on consumer goods. This, in turn, would have reduced retail sales tax revenues and, therefore, reduced the value of the retail sales tax expenditures discussed later in this paper.

In spite of these limitations, this study identifies the extent and variety of tax expenditures in which the Province is involved. It highlights how tax expenditures are provided for both individuals and corporations as income is earned, as it is spent and as it is invested.

Changes to some of the tax expenditures discussed in this paper, or the addition of new tax expenditures, may be proposed in the 1986 Budget. These have not been anticipated in this paper.

Personal Income Tax

Under the federal-provincial Tax Collection Agreement, the federal government determines the personal income tax base and basic federal tax. The participating provinces then set their tax as a percentage of basic federal tax. In return, Ottawa collects and administers the tax on behalf of participating provinces. As a result, Ontario shares in the cost of the tax expenditures related to the federal base, but has no direct control over the associated policy decisions. Only the Ontario Tax Reduction and Ontario Tax Credits fall under Provincial jurisdiction.

Except where otherwise noted, the Ontario share of tax expenditures relating to the personal income tax has been costed at the margin, by comparing the total tax generated under the current system with the total tax that would be generated in the absence of the tax expenditure.

Basic Personal Exemption

In 1983, the basic personal exemption was set at $3,770. In that year, 5.7 million Ontario taxfilers claimed this exemption at an estimated cost of $2.46 billion.

Exemption for Dependent Children

There are two levels of exemption for dependent children. In the 1983 tax year there was a maximum $710 exemption for each child under 18 and a maximum $1,300 exemption for each child between 18 and 21. Children over 21 may be claimed under the exemption if they are in full-time attendance at a school or university, or are infirm. In 1983, 1.3 million Ontario taxfilers claimed this exemption. It cost Ontario an estimated $151 million for the exemption for children under 18, and $41 million for the exemption for children 18 and older.

Married Exemption

The married exemption is available to a taxfiler whose spouse is, for tax purposes, considered a dependant. In 1983, the exemption was set at a maximum of $3,300, and was claimed by 805,000 Ontario taxfilers at an estimated cost of $289 million.

Equivalent-to-Married Exemption

The equivalent-to-married exemption is equal in value to the married exemption, and may be claimed if the taxfiler is single, divorced, separated or widowed, and supports a relative living with the taxfiler. In 1983, approximately 219,000 taxfilers claimed this exemption, at an estimated cost to Ontario of $54 million.

Exemption for Other Dependants

Eligible dependants under this exemption include parents, grandparents, brothers, sisters, aunts, uncles and in-laws. The level of the exemption is the same as the child exemption, both for those under and over 18, and is reduced by income earned by the dependant. In 1983, 25,000 Ontario residents claimed this exemption at an estimated cost of $6 million.

Age Exemption

The age exemption is available to all taxfilers aged 65 or older. In 1983, the exemption was set at $2,360 and was claimed by 573,000 Ontario taxfilers at an estimated cost of $119 million.

Disability Deduction

This deduction is available to people who are blind, or are confined to a bed or wheelchair, and may also be claimed for a dependent spouse or other dependant in these circumstances. In 1983, the deduction was set

at $2,360 and was claimed by 21,000 Ontario taxfilers at an estimated cost of $4 million.

Employment Expense Deduction

This deduction, which recognizes some of the expenses incurred in the normal course of employment, is equal to 20 per cent of employment income to a maximum of $500. This deduction was claimed by 4.2 million taxfilers and cost Ontario an estimated $197 million in 1983.

Moving Expenses

Moving expenses for which a taxpayer has not been reimbursed may be claimed by individuals who move at least 40 kilometres closer to their new workplace. In 1983, 34,000 Ontario taxfilers claimed this deduction at an estimated cost to the Province of $5 million.

Child Care Expense Deduction

Expenses paid for child care services that enable single parents or both spouses in a two-parent family to earn income or attend an educational or training program are deductible from income. In 1983, the deduction was a maximum of $2,000 per child for up to four children. In 1983, 179,000 Ontario taxfilers claimed this deduction at an estimated cost of $25 million.

Unemployment Insurance Premium Deduction

Most people earning employment income must pay Unemployment Insurance premiums, and these are deductible for tax purposes. In 1983, 3.9 million Ontario taxfilers claimed this deduction at an estimated cost of $131 million.

Canada Pension Plan Deduction

Most individuals who earn income from employment or from self-employment must contribute to the Canada Pension Plan, and are allowed to deduct these contributions. This deduction represents a deferral of income for tax purposes. In Ontario, four million taxfilers claimed the deduction in 1983 at an estimated cost of $111 million.

Union and Professional Dues Deduction

Annual dues for membership in a union, professional or other qualifying organization are deductible for tax purposes. In 1983, 1.5 million Ontario taxfilers claimed this deduction at an estimated cost of $42 million.

Tuition Fee Deduction

Tuition fees may be deducted by anyone attending an accepted post-secondary institution. In 1983, 461,000 Ontario students claimed this deduction at an estimated cost of $16 million.

Education Deduction

This is a $50 per month deduction available to full-time students while enrolled in a qualifying program, and any unused portion may be claimed by a supporting taxfiler. In 1983, 303,000 Ontario taxfilers claimed this deduction at an estimated cost of $9 million.

Registered Pension Plan Contributions

A deferral of tax on contributions to a Registered Pension Plan (RPP) is available in the form of a deduction up to prescribed limits; in 1983 the maximum was $3,500. This deduction was claimed by 1.3 million Ontario taxfilers. The amount of income deferred in that year through RPP deductions cost Ontario an estimated $188 million in foregone revenue.

Registered Retirement Savings Plan Contributions

As with the RPP, tax on contributions to a Registered Retirement Savings Plan (RRSP) can be deferred in the form of a deduction up to a prescribed maximum. The maximum limit is governed by the individual's income in that year and any amounts contributed during the same year by the taxfiler to an RPP. In 1983, one million Ontario taxfilers claimed RRSP deductions. The amount of income deferred in that year through the RRSP deduction cost Ontario an estimated $247 million.

Pension Income Deduction

This provision allows individuals, usually seniors, to deduct up to $1,000 of their eligible pension income. In 1983, 444,000 Ontario taxfilers claimed this deduction at an estimated cost of $37 million.

Charitable Donations

The maximum provision for charitable donations is 20 per cent of the taxfiler's net income, and donations above this limit may be carried forward for up to five years. In 1983, 816,000 Ontario taxfilers claimed a deduction for charitable donations at an estimated cost of $74 million.

Medical Expenses

Medical or dental expenses for which the taxpayer is not reimbursed by a public or private plan are deductible. While there is no prescribed maximum for the deduction, only that portion of expenses in excess of 3 per cent of the claimant's net income is eligible. In 1983, 152,000 Ontario taxfilers claimed medical or dental expenses at an estimated cost of $16 million.

Taxable Capital Gains/Allowable Capital Losses

A capital gain is the difference between the purchase price and the selling price of an investment. In general, half the investment gains and losses

are added to, or deducted from, taxable income. A maximum of $2,000 in allowable capital losses can be claimed against other income in any one year.

The cost to Ontario of adding only 50 per cent of net capital gains to taxable income, instead of 100 per cent, was an estimated $117 million in 1983, benefitting 383,000 Ontario taxfilers. This estimate does not include the portion of realized gains that accrued prior to 1972, when gains first became taxable.

Non-Taxation of Capital Gains on the Sale of a Principal Residence

The appreciation in value of owner-occupied principal residences is not taxed when the property is sold, nor are losses deductible. It is estimated that this exemption represented $145 million in foregone revenue in 1981, assuming that the gains would have been fully included in income, and that all taxpayers paid an average marginal rate of tax.

Canadian Films

Investments in films meeting Canadian content requirements may be fully deducted from income. (This tax expenditure parallels the corporate accelerated Capital Cost Allowance, which is discussed in the Corporate Income Tax section.) The amount of income deferred in 1983 as a result of this deduction cost the Province an estimated $2 million in that year.

Allowable Business Investment Losses

Unlike other capital losses, where only $2,000 may be deducted from other income, there is no limit on the deduction of capital losses arising from the sale of shares of Canadian-controlled private corporations. In 1983, this provision is estimated to have cost Ontario $8 million.

Non-Taxation of Lottery and Other Gambling Winnings

Winnings from lotteries, racetracks or other authorized gambling outlets are not taxed, although the income generated from the winnings is taxable. Assuming an even distribution of winnings across all taxpayers, this tax expenditure cost an estimated $72 million in Ontario in 1983. It is worth noting, however, that if winnings became taxable, consideration would have to be given to allowing a deduction for the cost of ticket purchases. This has not been included in the cost estimate.

Interest and Dividends Deduction

The first $1,000 of eligible income generated through a wide variety of Canadian investment sources is deductible from income. In 1983, 2.9 million Ontario taxfilers claimed this deduction at an estimated cost of $178 million.

Dividend Tax Credit

The tax treatment of dividends under Canadian tax rules attempts to provide a measure of integration between corporate and personal income taxes. Because dividends, unlike other income received by individuals from corporations, are paid out of after-tax profits, the personal income tax rules take into account the tax paid by the corporations.

Dividend income received by individuals is, for tax purposes, "grossed-up" or increased to approximate its before-corporate-tax value and included in personal income. Individuals receiving dividends are then provided with a tax credit to recognize that corporate taxes have already been paid.* Because both the gross-up and the tax credit affect the base for calculating provincial income taxes, Ontario shares in its impact. Since the purpose of the credit is to recognize taxes already paid, it is generally not regarded as a tax expenditure.

Carrying Charges

Individuals may deduct the interest costs on money borrowed to make investments, as well as fees for investment counselling and other investment-related expenses. In 1983, 771,000 Ontario taxfilers claimed this deduction at an estimated cost of $58 million.

Personal Income Tax Expenditures within Ontario's Jurisdiction

The following three tax expenditures fall solely within Ontario's jurisdiction and are not cost-shared with the federal government. They are, however, included on the federal-Ontario personal income tax return.

Ontario Tax Reduction

In the 1985 Ontario Budget, the Province enriched its tax reduction program. During 1986, individuals with taxable incomes of less than $1,630 will be relieved of Ontario tax, and individuals with taxable incomes between $1,630 and $1,760 will have their taxes reduced. In 1986, 390,000 Ontario taxfilers are expected to claim a full or partial Ontario Tax Reduction at an estimated cost of $10 million.

Ontario Tax Credits

The Ontario Tax Credits, which appear on the purple pages of the tax return, have two components: a property tax credit, available to homeowners and tenants, and a sales tax credit. The credits are available only to taxfilers under 65 years of age, are limited to a maximum of $500 and are reduced by 2 per cent of the claimant's taxable income. (Persons aged 65 and over are eligible for Ontario Tax Grants.) In 1983, 1.8 million Ontario taxfilers claimed Ontario Tax Credits at an estimated cost of $280 million.

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* In 1986, individuals will gross up their dividends by 50 per cent and include that value as income. Personal income tax will be calculated on this grossed-up value but will be offset by a combined federal-provincial tax credit of approximately 34 per cent of the grossed-up value. The Ontario share of the credit is about one-third of the total. For some individuals, the credit will more than offset the personal income tax paid on the grossed-up dividends; for others, it will only partially account for the tax paid.

Ontario Political Contribution Tax Credit

An Ontario tax credit of up to $500 is available to offset a portion of contributions made to registered provincial political parties. In 1983, this cost Ontario $2.6 million, benefitting 35,000 Ontario taxfilers.

Corporate Taxes

CORPORATE INCOME TAX

Ontario collects and administers its own corporate income tax and has instituted certain variations from federal policy in order to pursue specific Provincial policy goals. In general, Ontario parallels federal corporate income tax policy in order to minimize the cost of compliance for firms. All corporate tax expenditures in Ontario are the result of Provincial government policy decisions. The benchmark corporate income tax base is assumed to be total corporate revenues less related expenses. Tax expenditures can occur when the tax rules permit a taxpayer to claim an expense deduction that is greater than the expenses actually incurred, or when a taxpayer may claim expenses before the associated revenues are recognized for tax purposes.

The benchmark tax rate is assumed to be the statutory general rate.

Excess of Tax Depreciation Versus Book Depreciation

When a company acquires a capital asset, which can be anything from a typewriter to an apartment building, it is allowed to deduct a portion of the cost of that asset according to the prescribed capital cost allowance (CCA) rates. It is possible for a company to achieve an indefinite postponement of a portion of its income tax liability where the CCA claim in a year exceeds the accounting depreciation charge.

The difference between CCA claims and the depreciation charges made by accountants is due to a variety of factors. Among them:

- Capital cost allowance rates do not always reflect the estimated useful life of an asset. As a result, CCA rates often exceed those allowed for accounting depreciation purposes. In particular, accelerated CCA rates are available for certain assets employed in such activities as manufacturing and processing, mining, communications, drilling, rail transportation, pollution control and energy conservation. Moreover, all research and development (R&D) capital costs may be immediately expensed for Ontario income tax purposes.

- Under generally accepted accounting rules, the depreciation of assets over their useful life usually means depreciation does not commence until the assets are actually being put to use in the business to earn income. Under CCA rules, however, claims may commence while the asset is being constructed, which could be years before it is ready to contribute to the company's income-earning activities.

- While accounting depreciation is generally claimed on an asset-by-asset basis, CCA rules allow assets of a similar nature to be pooled or grouped by classes. Since CCA rates are usually more generous than those used by accountants, a pooling of assets can extend the period during which taxes can be deferred. Sometimes these deferrals can be extended indefinitely, as long as new assets are added to the pool.
- Since the accounting rate is based on the estimated useful life of the asset, depreciation charges are made annually on a regular schedule. On the other hand, CCA rates specify the maximum allowable claim that may be made in a year; it is then at the discretion of the corporate taxpayer whether to use less than the maximum available claim in a year in order to minimize future taxes.

It should be noted that the estimated cost of the tax expenditure incorporates the benefits to the company of federal investment tax credits. Investment tax credits are provided by the federal government to companies that incur costs of a current or capital nature in qualifying activities. As such, investment tax credits of a capital nature must be deducted from the cost of assets prior to claiming CCA.

Taking all these factors into account, the income deferred in 1982 due to the excess of tax depreciation over book depreciation cost Ontario an estimated $246 million in that year.

Capital Gains

As is the case for individuals, only one-half of most capital gains is taxable, and one-half of capital losses can be used to offset taxable capital gains. In 1982, the cost of the tax expenditure associated with the non-taxable half of capital gains realized by corporations was an estimated $131 million.

Allowable Business Investment Losses

As with the personal income tax, capital losses arising from the sale of shares of Canadian-controlled private corporations may be used to reduce corporate income from any source. The cost of this tax expenditure is estimated to be less than one million dollars annually.

Small Business Development Bonds

Small businesses in financial difficulty may issue small business development bonds (SBDBs) to financial institutions. The interest paid on these bonds is neither deductible for the small business nor taxable in the hands of the recipient.

The SBDB program covers debt instruments issued prior to 1988. The tax expenditure associated with small business development bonds costs Ontario an estimated one million dollars annually.

Small Business Development Corporations Program

This program entitles investors to receive an Ontario Government grant (for individuals) or a tax credit (for corporations) based on an investment in eligible small businesses through an approved Small Business Development Corporation.

Tax credits received by corporations normally will be equal to 25 per cent of the amount invested, unless the investment is made in northern or eastern Ontario, where the rate is 30 per cent. For 1985, the tax credits approved totalled $645,000. Some deferral of this tax expenditure may occur because it is at the discretion of the corporation when the credit is actually claimed for income tax purposes.

Small Business Deduction

Canadian-controlled private corporations that qualify for the federal small business deduction are eligible for a reduction of their Ontario corporate income tax rate to 10 per cent on the first $200,000 of eligible income.

For the fiscal year 1984-85, the cost of the tax expenditure associated with the small business deduction is estimated to be $210 million.

Three-Year Income Tax Exemption for New Qualifying Corporations

In the 1984 Ontario Budget, a three-year corporate income tax exemption was introduced for companies starting up in Ontario. To qualify, the company must be privately controlled by Canadians, and unrelated to any other company. The exemption only applies to the corporation's first three taxation years. To maximize the benefits of this exemption, start-up companies may decide to defer certain deductions to future taxable years, provided that the basis for the Ontario income computation is consistent with that used for federal purposes. In the 1984 Budget, the annual cost of this tax expenditure was estimated to be $45 million, but it is recognized that the impact of deferred deductions could increase the actual cost of the exemption.

Reduced Corporate Income Tax Rate for Specified Sectors

A one per cent tax rate reduction is provided for income earned from manufacturing, processing, mining, logging, farming and fishing. This tax expenditure cost an estimated $40 million in fiscal year 1984-85.

Mining Automatic Depletion Allowance

Ontario's automatic depletion allowance provides an effective deduction of one-third of the mining profits earned in a year. The estimated cost of this tax expenditure in 1982 was $25 million.

Exploration and Development Expenses

All Canadian and Ontario exploration and development expenses associated with mining activities are fully deductible. In 1982, this tax expenditure cost an estimated $4 million.

Ontario Mineral Exploration Program

Under the Ontario Mineral Exploration Program, junior exploration companies may receive a tax credit or grant equal to 25 per cent of eligible exploration expenses. Most of this assistance is in the form of grants. The cost of tax credits claimed in 1982 is estimated to have been $100,000.

CAPITAL TAX

All corporations in Ontario, with the exception of insurance companies, are subject to the capital tax. Insurance companies are subject to the insurance premiums tax.

Generally, the tax base for ordinary companies consists of both debt and equity, while the base for banks and loan and trust corporations consists of equity only. The narrower base for banks and loan and trust corporations is compensated for by a higher capital tax rate. For purposes of this analysis, both bases and associated rates are considered part of the benchmark capital tax structure.

Flat Capital Tax for Small Business

Generally, a company's capital tax liability is three-tenths of one per cent of its capital tax base. Corporations with taxable capital of not greater than $100,000 pay a flat $50. Where a corporation's taxable capital exceeds $100,000 but does not exceed one million dollars, it pays the lesser of the taxes otherwise owing or $100. Corporations whose taxable capital exceeds one million dollars but is less than $1.2 million are eligible for the "notch provisions", which phase in the regular capital tax computation. The cost of this assistance in fiscal year 1982-83 is estimated to have been $60 million.

Retail Sales Tax

The policy and administration of the retail sales tax (RST) falls under the jurisdiction of the provincial government.

The benchmark base for the retail sales tax is assumed to include sales of all tangible personal property (such as cars, furniture and pens) and of all services. There are, in fact, four retail sales tax rates in Ontario, but the general rate of seven per cent applies to the majority of transactions. In this study, the seven per cent rate is considered to be the benchmark rate, with the 10 per cent rate on admission fees being the one exception. All costs are on a calendar year basis.

Groceries

There is no retail sales tax on grocery store food, except for soft drinks, snack foods and confections. The cost of the exemption on grocery food was an estimated $650 million in 1982, the most recent year for which data are available.

Child-Rearing Expenses

Children's size clothing is exempt from retail sales tax. In 1985, this exemption cost an estimated $54 million.

In the 1985 Ontario Budget, it was announced that children's car seats would be exempted from RST. This exemption took effect in January, 1986, at an estimated cost of $0.5 million for this year.

Footwear

There is no retail sales tax on footwear priced at $30 and under. In 1985, this exemption resulted in approximately $33 million in foregone revenue.

Prescription Drugs

All drugs prescribed by a doctor, dentist or veterinarian are exempt from retail sales tax. The exemption of prescription drugs used by people cost approximately $40 million in 1984 (including drugs paid for by the Ontario Drug Benefit Plan and by private insurance plans). Reliable data are not available for drugs prescribed by veterinarians.

Feminine Hygiene Products

In the 1985 Ontario Budget, feminine hygiene items were exempted from retail sales tax at an estimated cost of $7 million in 1986.

Prepared Food Products Costing One Dollar or Less

In the 1985 Ontario Budget, prepared food products costing (in total) one dollar or less and purchased at an eating establishment were exempted from retail sales tax.

This exemption took effect in January of 1986 at an estimated cost of $35 million for this year.

Dental Appliances, Prescription Optical Appliances and Hearing Aids

Dental appliances (such as dentures), prescription optical appliances (eye glasses and contact lenses) and hearing aids are exempt from retail sales tax. It is estimated that the exemption for dentures cost $4 million and the exemption for prescription optical appliances cost $9 million in 1982. Comprehensive data are not available for other dental appliances or hearing aids.

Aids for the Physically Impaired

A range of items used by the physically impaired is exempt from retail sales tax, including prosthetic and orthopaedic devices. However, reliable sales data are not available for these items.

Vehicles purchased to transport the physically handicapped are eligible for an RST rebate. Refunds totalled $5 million in 1985. In addition, modifications made to the vehicle to accommodate the handicapped (such as hand controls or wheel chair lifts) are specifically exempt from RST; there are no cost data available for these items.

Reading Material

Magazines purchased on subscription, books, newspapers, publications of a religious, charitable or benevolent organization, and audio-visual educational aids (purchased by school boards, universities and public libraries) are exempt from retail sales tax. In 1982, the exemption for printed reading materials cost $50 million. The exemption of audio-visual educational aids cost less than one million dollars in 1983.

Works of Art Purchased by Museums

Works of art purchased by a museum or art gallery in Ontario are exempt from retail sales tax if more than 50 per cent of the establishment's revenue is provided by public donations and grants. The cost of this exemption fluctuates from year to year but since most artwork is donated, the annual cost is unlikely to exceed one million dollars.

Religious and Charitable Organizations

Religious, charitable, benevolent and other non-profit organizations may sell items at fund-raising events without collecting RST, provided they pay tax on purchases of items for resale and the events are not held on a regularly scheduled basis. Used clothing and/or footwear under $50 sold by these organizations is also tax-exempt, as are meals sold at a nominal charge. No cost can be estimated for these exemptions due to a lack of data.

Most items purchased by a religious institution to be used in that part of its premises where religious worship or sabbath school is regularly conducted are tax-exempt, as are most texts and publications used in promoting religious worship or instruction. These organizations need not pay RST on labour and manufacturing costs incurred in setting up their own theatrical productions; the materials, however, are taxable. Data are not available for the cost of these exemptions.

Religious, charitable and benevolent organizations are entitled to certain tax refunds relating to construction materials. (These refunds are not available to other non-profit groups.) In 1985, refunds totalled $6 million.

Fire-Fighting Vehicles

Fire-fighting vehicles are exempt from retail sales tax when purchased at a price of more than $1,000 per vehicle for the exclusive use of a municipality, public hospital, university, local service board or volunteer group. Also exempted are repair expenditures for such vehicles. This exemption cost approximately one million dollars in 1985.

Hospital Purchases

Medical and surgical equipment purchased by a hospital is exempt from retail sales tax. The cost of the exemption is estimated at $10 million for 1985.

Soil and Water

There is no tax on sales of soil and natural water (including ice and steam). Clay, sand, gravel and unfinished stone are also tax-exempt, at an estimated cost to Ontario of $30 million in 1984.

Energy (excluding Motive Fuels)

Electricity, natural gas, coal, coke, firewood, heating oil, propane and manufactured gases are exempt from the seven per cent retail sales tax. In 1984, the electricity exemption cost an estimated $300 million, including industrial, commercial and residential consumption; the natural gas and propane exemptions cost an estimated $241 million and $20 million, respectively.

In addition, vehicles that can operate on non-conventional fuels and conversion kits to allow them to do so are exempt from RST. In 1985, these exemptions cost approximately $10 million.

Production Machinery and Equipment

Manufacturers are granted an exemption from the seven per cent retail sales tax on production machinery and equipment, as well as on repair expenditures on that machinery. In 1985, this exemption represented approximately $450 million in foregone revenue.

Heavy Trucks

Trucks with a gross mass vehicle rating (GMVR) in excess of 11,778 kilograms are exempt from the seven per cent retail sales tax. The exemption includes trucks, truck trailers, tractor trailers and semi-trailers designed for carriage of freight with the above-mentioned GMVR. In 1985, the exemption cost an estimated $65 million.

Merchandise Trade-ins

If a vendor accepts merchandise (taxable under the Retail Sales Tax Act) as partial or total payment towards the sale of taxable merchandise, then the RST is calculated on the difference between the fair market value of

the property sold and the credit allowed for the merchandise traded-in. There are no data available on the cost of this tax expenditure. For motor vehicle trade-ins alone -- a significant portion of the total -- this tax expenditure cost an estimated $250 million in 1984.

Aircraft and Aircraft Parts

Aircraft and parts, equipment or repairs for such aircraft are exempt from retail sales tax when used by an approved carrier of goods or passengers. Cost data are not available on aircraft sales in Ontario.

Farming

The Retail Sales Tax Act provides extensive exemptions to those persons engaged in the business of farming. Farm implements, machinery and equipment are exempt from the seven per cent tax, at an estimated cost of $40 million in 1985. Repair and maintenance costs of such machinery are also exempt, at an estimated cost of $10 million in 1985. Other major exempt purchases include fertilizers, pesticides, seed, agricultural feed, twine and wire, which amounted to a tax expenditure of approximately $85 million in 1983.

Fishing

Boats, fishing nets and certain other fishing equipment are exempt from the seven per cent tax when purchased by commercial fishermen. Also exempt are vessels exceeding 1,400 cubic metres, and those not exceeding 1,400 cubic metres if operated for commercial purposes. In 1984, this represented foregone revenue of less than one million dollars.

Fur-Trapping

Trapping equipment purchased by a licensed trapper is exempt from retail sales tax. In 1984, this exemption cost less than one million dollars.

Services

Most services are excluded from the retail sales tax base. The following costed tax expenditures are examples of the three major groups of services that are not subject to tax. A number of other services not subject to tax, such as dental and legal services, are not addressed in this paper due to a lack of data.

Several services can be categorized as professional. The exclusion of management and business consulting services cost an estimated $10 million. Excluding engineering and architectural services resulted in tax expenditures of $59 million and $13 million, respectively. All cost estimates are for 1982.

There are two easily identifiable commercial services. The tax exclusion for computer services cost approximately $34 million in 1983 and the exclusion for advertising cost an estimated $110 million in foregone

revenue in the same year. The non-taxation of insurance premiums cost approximately $420 million in 1984.

Among personal services, the exclusion of dry cleaning and laundering services represented foregone revenue estimated at $21 million in 1982. The non-taxation of hairstyling and barbering, along with beauty and skin care services, cost approximately $39 million in 1982.

Transient Accommodation and Visitors to Ontario

Transient accommodation is taxable at the rate of five per cent. The difference between this rate and the benchmark rate of seven per cent represented an estimated $15 million tax expenditure in 1983.

Out-of-province visitors to Ontario are eligible for a refund of RST paid. In 1985, rebate claims totalled one million dollars.

Admission Fees

Until 1969, the tax on admission fees fell under the jurisdiction of the Hospitals Tax Act of 1948. In 1969, when admission fees became part of the retail sales tax base, the 10 per cent tax rate was maintained. Because the origin of the tax on admission fees lies outside the Retail Sales Tax Act, it is considered to be a benchmark rate separate from the seven per cent rate.

The 10 per cent tax does not apply on admissions costing $4 or less. For motion picture theatre admissions alone, this exemption cost $5 million in 1983.

In addition, the full admission price for charity-sponsored or Canadian events is exempt from this tax. This exemption represented estimated foregone revenues of $15 million in 1985.

Alcohol, Tobacco and Motive Fuels

In Ontario, the taxation of alcohol, tobacco and motive fuels is governed by Acts that are distinct from the Retail Sales Tax Act which sets the Province's major consumption tax. As a result, it is difficult to decide how to incorporate them into a tax expenditure catalogue. In addition, the tax rates within each of these areas do not present a readily identifiable benchmark. Accordingly, no general attempt has been made to address tax expenditures within these areas.

Certain identifiable tax expenditures are the exemptions for specific uses. In particular, motive fuels used in the business of farming are exempt from fuel taxes. In 1985, these exemptions cost approximately $20 million for diesel fuel and $8 million for gasoline (based on the rates in place for those fuels). Gasoline and diesel fuels for off-road use are also exempt from tax. Such uses would include institutional or industrial purposes, such as heating or cooking. These have not been treated as tax expenditures in this paper because it is not clear what benchmark rate would be appropriate.

Conclusion

This paper has laid the groundwork for examining Ontario's tax expenditures by providing basic information, including estimates of cost where possible, on tax expenditures under Ontario's major tax statutes. This information is essential to the assessment of tax expenditures, both in terms of the benefits to the economy and contributions to other policy goals.

It should be emphasized that these costs cannot be added up to determine the potential savings resulting from the elimination of all tax expenditures. Not only is there no way of estimating the true aggregate cost of these measures, but such an exercise is also unrealistic because it is inevitable that there would be other policy adjustments aimed at keeping tax burdens roughly unchanged.

What is important is to continue to assess the effectiveness of specific tax expenditures, both in terms of their original goals and in terms of changing priorities. The costs provided here represent one factor in that assessment. The challenge is to improve upon the methods for evaluation presently available, so that policy decisions about tax expenditures can be made on a realistic and reliable basis.